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THE IMPERATIVE OF CREDIT-BAIL REFORM

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Executive Summary

Legislative reform commissions typically attempt to codify. It is extraordinary that they initiate consideration of policy changes. Yet, in considering reform of the 1996 law on credit-bail, the *Commission de Réforme du Droit des Affaires* (CRDA) in the months of February – March, 2000 accomplished just this. Rarely has a Malagasy commercial law offered such promise and delivered so little as the current law on *crédit-bail*. Focused as it is on the model of an established, moneyed *crédit bailleur* leasing to a *crédit preneur* with an established business history, the current law reduces these parties to phantoms, commercial fictions. It was written for a Malagasy economy having resources and a course of business dealing that do not yet exist.

This, the CRDA's first commercial legal reform of the new century, hits home – in the most positive sense. The CRDA has made *credit-bail* relevant to Malagasy small shops and even households. In a matter of weeks, CRDA transformed consideration of *credit-bail* policy from its heretofore irrelevant and static model by focusing on the structure of *credit-bail* as a business transaction at grassroots level, driven by the mutual expectations of parties. CRDA has thus made crédit-bail understandable to the cottage business in the smallest hamlet. Nor is any of this at the expense of international standards. CRDA accomplished its task by using a deft combination of legal, business and regulatory policy advice drawn from domestic and international corners. The CRDA's reform draft law thus offers:

- incentives to the modest *crédit preneur*, whose main asset is individual initiative

- protection to a fledgling *crédit bailleur* from the undue risks associated with this transaction

- the potential to reverberate from household to regional economic significance, as a model not only for the island and but for the continental economies of the Indian Ocean

Finally, the practical, grassroots approach of the CRDA has yielded one frank but productive admission. It is that more than willing parties that are required for crédit-bail. So is property. Focus must thus be on utility as well as understanding, on the engineering as well as the architecture of the transaction. This means attention to the issue of third-party financing in order to get property into the hands of the fledgling *crédit bailleur* catering to the *crédit preneur* of modest means. The CRDA has reserved this issue for special consideration by a wide audience of government policy makers and sponsored special presentations on the question. There is strong reason to believe that the CRDA will place the practical issue of third-party finance, along with licensing, accounting and tax questions, foremost in its implementation strategy.

The text as proceeds chronicles and explains the full significance of the CRDA's approach.

I. Introduction

In the Fall of 1999, the CRDA requested assistance in the development of a draft revision of the current law on crédit-bail. The moment could not have been more propitious for a variety of reasons. These include the following:

- the need to maximize the use of such local capital as exists through an empowerment tool that at once reaches small and medium-sized businesses marginally capable of meeting a lease obligation but at the same time seeking business expansion with the kind of opportunity afforded by an option to purchase

- the need to mobilize the new presence of foreign capital in the Malagasy economy as evidenced by accelerated foreign bank participation

Between them, these two reasons give rise to questioning the adequacy of the current law on crédit-bail. Though enacted in 1996, the current law was largely in advance of the above two developments and quite in advance of the formation of the CRDA. Though some international advice may have been received in connection with crédit-bail, it was largely in the context of the appropriateness of the current law from a strictly juridical standpoint.

The result has been that the current law is hardly used and the empowerment capabilities of crédit-bail hardly understood. This is the case in at least two contexts, the first related to the inability of the current law to communicate the essence of crédit-bail to a potential audience of small and middle market users. This is precisely the business clientele that can most benefit from a reform law. The second reason for the inadequacy of the present law is perhaps more telling. It relates to the law's usefulness to the financial community. Specifically, there is nearly a complete absence of recognition in the present law of the one ingredient necessary for crédit-bail to work in Madagascar: capital. The structure of capital markets in Madagascar is simple, with reliance on banks as lenders of first and last resort. It is thus not surprising that the banks would be expected to occupy the role of both financier and proprietor, that is financier of the property and *crédit bailleur* at the same time. Yet, extensive surveys and business experience have demonstrated that, even before the recent accelerated foreign participation in Malagasy banking, banks were overextended in terms of the multifaceted roles that the local business community expected them to play. Additionally, crédit-bail both contemplates a very specific purpose at the end of the lease period, the purchase of the asset in question by the *crédit preneur*, and entails substantial allocation of bank resources for monitoring measured against the risk that the purchase may not take place. Finally, Madagascar is a country in which the borrower profile has not been without the feature of misuse and improper appropriation of bank funds. World Bank Country Study: Madagascar, International Bank for Reconstruction and Development, 1993, p.p. 152, 154-55 (hereinafter referred to as IBRD Study). Therefore, the recent infusion of foreign capital into the traditional banking sector is likely to fortify conservatism in the short term as what had been previously domestic banks are now stringently audited by home offices and headquarters abroad.

The cumulative effects of these developments justify the CRDA's inquiry into the adequacy of the present law on crédit-bail, despite its recent vintage and ostensible international pedigree. What follows is an attempt to explain the decisions of the CRDA in terms of overall leasing policy, both against the backdrop of international standards and as a specific response to the practical issues and problems raised by the 1996 law on crédit-bail. This focus on the conceptual bases for the CRDA's decisions is not idle discussion. To the contrary, it will provide the basis for concrete recommendations as to the amendment of existing Malagasy laws and practices to reflect, or more importantly, facilitate the new sort of crédit-bail transaction envisioned by CRDA.

II. Crédit-Bail on the Path to a Universal Transaction: International Trends

Happily, the most prominent international trend relative to leasing law today is the focus on actual practice as the basis for the law. Happily for Madagascar, a focus on the practicalities as exemplified by this international discourse will in large part remedy the two current problems with the 1996 law, failure to communicate the transaction to a potentially huge community of small and middle market users and lack of usefulness to the financial community.

Economics, not adherence to particular legal traditions, is now driving a consideration of crédit-bail as a transaction. Economics has proven the common language bridging the gap between legal cultures. Common law jurisdictions are now codifying leasing law while civil law countries are abandoning rigid adherence to civil code form and Continental tradition to incorporate economic policy into leasing laws. *Compare* Uniform Commercial Code, Article 2A Amendments (1990) (hereafter cited as UCC, Article 2A) *with* Commentary by New York law firm Herzfeld & Rubin on Romanian law on "Leasing Operations and Leasing Societies," Government Ordinance No. 51/28, August, 1997. In fact, civil code regimes around the world have been quick to acknowledge this trend. They have offered a wide variety of provisions to accommodate local economic realities, as exemplified by:

- the heavy emphasis of capital intensive countries like Brazil on sources of funds for crédit-bail versus countries with economies less rooted in market traditions from the former Soviet Union like Krygyzstan, whose recent tradition is far less concerned with capital flow

- import dependent countries like Romania assigning customs issues an important place in executive authority regulating leasing versus largely self-sufficient, isolated economies like China, the principal legal authority of which does not explicitly acknowledge the international dimension of leasing

Despite the variation, one fact is confirmed by these jurisdictions: the need to tailor laws to current economic demands of a specific country. But just how can one plot a course of direction for crédit-bail in Madagascar given these trends?

A part of the answer for Madagascar begins with exploring the very definition of crédit-bail itself. For example, two of the world's major transitional economies reliant on the code system

treat crédit-bail in different ways. Russia, with a pedigree of Western business experience dating to the eighteenth century, adopted in 1998 a definitive, deterministic notion of leasing transactions, in which the ownership by the lessee was certain upon expiration of the lease. "Federal Law on Leasing", Russian Federation, Article 3, October 29, 1998 (hereafter cited as FLL). This position has the advantage of attracting a market for leasing in that it gives the lessee a guaranty of purchase at the end of the lease. China offers a contrasting position on the nature of the lease and the legal obligations at the commencement of the lease. The Chinese have opted for an open, non-deterministic model of responsibilities. The Chinese model permits deferrals of the decision on even whether to offer the lessee the possibility of purchase until the termination of the lease. "The Economic Law of China Regarding Lease Contracts," People's Republic of China, Articles 249-250 (unofficial translation, as in effect in 1999). This position has the advantage of flexibility and perhaps imposing on the lessee the subtle pressure of care of the property and performance of routine lease obligations so as to "earn" the right to purchase at the end of the lease term. The Chinese model thus defers to the *crédit bailleur*'s interest in monitoring lessee performance. While it may lack predictability as to the disposition of the asset subject to lease, it offers stability to the lessor and the opportunity to evaluate lessee performance.

As the more European model, the Russian alternative takes greater account of crédit-bail as a credit product subject to demand in the free market. This is evidenced by its greater attention to the needs of the *crédit preneur* and its greater emphasis on transactional transparency through putting third parties on notice of the purchase of the asset subject to lease by the lessee. It is thus not surprising that this emphasis has lead to an expansion of the concept to a market for crédit-bail in other contexts. Most notably, this has occurred in the context of an expansion of the notion of property subject to crédit-bail. Russia and other CIS countries have, through reform legislation in the 90s, defined the cutting edge of innovation in this area. The principal criterion for inclusion in financial legislation in the former Soviet Union is that the property be non-consumable, that is not subject to easy depletion so as to jeopardize the claim of a lessor during the lease term. At the same time, this broader concept of property reflects a greater awareness of the varied market for *credit-bail*, from micro finance to the major international transaction levels. *Compare* FLL, Article 3 *with* Law on Financial Leasing, Republic of Kyrgyzstan, Article 603. This flexibility is in part attributable to the continental code system, which perhaps more easily accommodates such inclusiveness for its emphasis on possession and use of property rather than title. By comparison, the main countries of the Indian subcontinent, more influenced by Anglo-Saxon law, tend even now to limit treatment of leasing to goods in trade.

An easy hypothesis for Madagascar might now be seen to develop. Both the traditionalist relying on code tradition and the supporter of the more modern trend to economic analysis may have a common cause. They might both arguably favor the European, Russian model. But this easy solution cannot go without an analysis of the consequences of the model at small firm and household level.

Indeed, another aspect of the European model explains the greater trend to an expansive view of property. This aspect has definite implications at small business and household level. It is a tendency to view crédit-bail's object as an investment in the total activities of a firm, rather than an isolated property transaction. This holistic view looks at the firm's tangible and intangible

assets. Thus, it is no accident that those jurisdictions, representing either modern or traditional Continental code philosophies, both reflect a more expansive view of property and also recognize that sources of finance other than the *crédit bailleur* may have to be introduced into the formal legal consideration of *crédit-bail*. *Compare* FFL, Articles 14 and 18; Herzfeld and Rubin, "Leasing in Romania" (Romania representing movement to liberalization on property and third-party issues) *with* Kothari, "The law of leasing in India"; Habib, "Leasing in Pakistan." The expansive view of investment in the total activities of the *crédit preneur* often requires that the *crédit bailleur* secure supplementary sources of funds, be the transaction at micro finance or international level.

This fact signals a major trend in modern commercial leasing: the abandonment of a model that views it as a two-party transaction in favor of a model identifying a third-party supplier or financier as economic requisites for *credit-bail*. As presented above, Russia and China represent polar models on the third-party issue. It is no surprise that the third-party issue should accompany the basic issue of the very definition of crédit-bail and the option to purchase discussed above. Both work in tandem in the modern economy to establish crédit-bail in transitional economies. Without money from a third-party, there is no possibility of a right to purchase, or a viable crédit-bail transaction. Hence, in the Russian model, the right to purchase is couched to serve notice to all concerned, including suppliers and financiers as possible third-parties, that the lessee will assume ownership at the expiration of the lease. The Chinese model may appear to favor the *crédit bailleur* for its emphasis on monitoring capability over the term of the lease. However, its obvious problem is that it makes it difficult for the third-party to know or, more to the point, to invest in what will happen at the expiration of the lease term. This difficulty inconveniences the *crédit bailleur*. In this sense, the Chinese model assumes the existence of financing in the context of a transitional economy.

A ready analysis of both trends focuses on the European, Russian emphasis on predictability, with its attendant advantages for the participation of third-party suppliers and financiers, while the Eastern (Chinese) tendency is to emphasize the behavior of the two essential parties to the lease and establish a trial period for determining the lessee's right, and not recognize the need for the lease as the object of investment by a third party. Both models have their merits. What is important to recognize is that despite shared recent ideological traditions and points in common as to stages of economic development, the economic position on receptivity to third-party investment is the determining difference in the two models.

What consequences then would adoption of the European model have for Madagascar? Among the countries influenced by the European code tradition, the definite tendency is more toward the European, Russian model and explicit recognition of third-party rights in the transaction. This also means establishing priorities among the lessee and the third-party, especially a third-party financier. The trend has worked its way to countries having both the Latin code tradition and transitional economies. Collectively, the leasing laws of Russia and Brazil, with two of the largest economies in the developing world influenced by the European code tradition, evidence this tendency. Brazilian Leasing Ordinance, #2,309, Article 19, August, 1996 (cited as BLO); FFL. Again, such progressive trends in civil code countries contrast markedly with the traditional model of leasing in Anglo-influenced countries, in which the emphasis is on leasing as for goods in trade and limits the third-party role to that of the supplier rather than a financier.

Compare FFL, BLO generally with Law No. 95 "Concerning Financial Lease", Egypt, 1995. Such progressive code jurisdictions have succeeded in making crédit-bail universal. Universal in that:

- it is an investment that takes into account the needs and operation of the entire firm as *crédit preneur*
- it opens the door for third-party participation
- it addresses needs at level of micro finance and international transaction alike

Thus, legal tradition, economics – both macro and micro, and the trend to universality, all point to Madagascar's adoption of the European model for crédit-bail. But might the advantages of the Eastern model be had as well? In posing the question, it is worth noting that virtually all of the citations to progressive trends have occurred since the date of passage of the present law on crédit-bail in Madagascar. It remains to consider how the ARD/Checchi/JURECO team collaborated with the CRDA to address these transcontinental and international trends in a reform law on crédit-bail.

III. ARD/ Checchi/ JURECO Implementation Strategy

A. Increasing Understanding: Empowering the Small and Medium- Sized Business

The unique empowerment of feature of crédit-bail is the option to purchase of the credit prenuer. Yet, the would be *crédit preneur* cannot be so empowered if he does not know of its existence. The present law on crédit-bail communicates no definition of what the transaction is. Rather, to the extent it communicates this feature, it is only in the context of personal property and is in any case phrased as an "operation" of crédit-bail rather than the essence of the transaction. Droit Bancaire, Chapitre IV, Articles 64, 67 (1996).

Consistent with the most recent European practices as noted above, the ARD/Checchi/JURECO team decided to place the option to purchase at the centerpiece of crédit-bail as a concept. Accordingly, it presented, and the CRDA approved, draft Articles 1-2 (set forth in Annex I), which place the option to purchase at the core of the transaction as part of the definition of crédit-bail. The option is thus not merely an aspect of the transaction's operation. This has profound economic implications, following from the articulation of international standards above:

- the creation of symmetrical and simultaneous expectations on the part of *crédit preneur* and *crédit bailleur* alike that the *crédit preneur* may purchase the asset subject to lease

- the empowerment of the *crédit preneur*, so that crédit-bail becomes a "work in progress" over the term of the lease, thus providing the credit prenuer with the motivation that comes with the perspective that the *crédit preneur* controls its destiny, as evidenced by the recognition that the *crédit preneur* may dictate the *crédit bailleur*'s acquisition of the asset subject to lease

- the necessary predictability accorded to the *crédit bailleur* as a party taking risks at the beginning of the lease, thereby facilitating a plan for the acquisition of resources further to crédit-bail, including not only the acquisition of the asset subject to lease but third-party financing to facilitate acquisition.

The decision of the CRDA to proceed with Articles 1-2 thus embodies empowerment through reinforcement of mutual expectation. Because the option to purchase is introduced as a part of the definition of crédit-bail and not merely part of the operation of the transaction, the empowerment feature covers not only crédit-bail mobilier but crédit-bail immobilier. It therefore considerably extends the reach of the right to purchase to the rich and ample Malagasy land assets.

This first of its kind definition of crédit-bail is a creative hybrid of both the European (Russian) and Chinese models. On one hand, it recognizes the "sweat equity" aspect of crédit-bail, by providing for a constant monitoring of *crédit preneur* performance over the course of the lease. In the Eastern manner, it serves as the quintessential motivational tool for small to medium-sized businesses whose principal asset is its diligence and commitment to overall firm development. On the other hand, fixing the right to purchase at the end of the lease reflects the more Western preference for predictability at the outset of the lease term, thus facilitating the calculations of the *crédit bailleur*, including those relating to the need for supply or financing by a third-party to facilitate the *crédit bailleur*'s acquisition of the asset in question.

As such, the CRDA' s empowerment through mutual expectation serves the following varied economic constituencies:

- small to medium-sized businesses as would be *crédit preneur*s now having an unqualified option to purchase as well as lease land as well as personal property, as a matter of definition

- potential microfinanciers and other *crédit bailleur*s currently in need of funding to proceed with crédit-bail and hence in search of predictability, who are assured that the transaction must now, by definition, include a right to purchase to be exercised on a date certain

- ordinary banks who might serve as third-party financiers of the *crédit bailleur* and who can now see an affirmative commitment by way of definition to the option to purchase at the end of the lease, thereby referencing their possible claims to the asset subject to lease against that of the *crédit preneur*

- large foreign investment houses who now see a path to risk sharing through the packaging of large groups of Malagasy assets, both real and personal, based on the certain existence of the collective options to purchase of several *crédit preneur*s (thereby following a 1993 World Bank prescription, IBRD Study, p. 152)

The CRDA's decision has the potential of representing a breakthrough for the island and even the continental economies surrounding the Indian Ocean. As noted, these economies almost without exception are wed to the century old concept of leasing as a two-party transaction limited to trade in goods. This anachronism extends even to jurisdictions such as Sri Lanka

which reflect a mixture of the Anglo-Saxon and Roman legal traditions in the context of leasing. See Kohari and Habib, *supra* (on subcontinent); Gilyeart. "Leasing law in Sri Lanka". Adoption of the first two Articles accepted by CRDA alone would place Madagascar at the forefront of the regional reform effort as to crédit-bail.

While Articles 1-2 as adopted by the CRDA represent a hybrid model, this characterization camouflages both the boldness of the CRDA' s move and the compensating intricacy of the balance stuck by CRDA to accommodate the interests of all parties involved.

- *Boldness* because CRDA's decision to accord the *crédit preneur* unilateral control over the option to purchase is more extreme in favor of empowerment of the *crédit preneur* than either the Eastern deferred or the Western deterministic models for crédit-bail, both of which give the *crédit bailleur* joint authority simultaneous with that of the *crédit preneur* to determine whether the option to purchase will be exercised

- *Balance* because the CRDA's empowerment model then had to compensate for the loss of control by the *crédit bailleur*

The CRDA achieved the necessary compensation for the interests of the *crédit bailleur* by comprehensive reform in one crucial area: public recordation of the interests of the *crédit bailleur*. Articles 9 - 19 on recordation provide clear direction as to the recent subtleties of recordation of the crédit-bail interests. Of course, such recordation is designed as a shield for the interests of the *crédit bailleur* against claims by creditors of the *crédit preneur*. Article 10 as adopted by the CRDA in particular calls for the public dissemination of precise economic information reflecting the *crédit bailleur*'s economic interests and the nature of crédit-bail. This contrasts markedly and favorably with Articles 66 and 69 of the present law which call for recordation of imprecise information. This commitment to transparency comports with the CRDA's attention to the expectations of the *crédit bailleur* at the inception of the lease. It also devotes equal attention to the protection of *crédit bailleur* interests and expectations over the lease term through establishing a comprehensive and full proof system for the recordation of *crédit bailleur* interests. The boldness reflects the CRDA's receptiveness to the Eastern model's emphasis on the initiative of the *crédit preneur*; the balance reflects the CRDA's recognition of the European model's concern for the *crédit bailleur*'s need for predictability.

As such, the CRDA' s decision reflects the international trend in leasing to universality by increasing public awareness of the expanded number of economic constituencies effected by the transaction.

But the CRDA undertook other decisions that contribute to the public's understanding of crédit-bail as universal in the internal as well as external sense. This has to do with crédit-bail's intra firm impact. Whereas Articles1-2 adopted by the CRDA reinforce the international trend to universalization of the transaction by both expanding the number of interested parties in the economy outside a firm and making them more secure in their expectations, Article 4 adopted by CRDA departs from the vagueness of Article 64, subarticle 2 of the current law to clearly cover tangible as well as intangible assets. This conforms to the modern, holistic view of crédit-bail as an empowerment tool that can govern all aspects of a firm's business. At the same time, this

holistic universality is not to be confused as imprecision in the legal sense, as the exact differentiation of types of property for recordation set forth in Articles 12 - 19 makes clear.

Brief though it is, Article 22 adopted by the CRDA is perhaps the *denouement* of the CRDA efforts to making crédit-bail understandable as a transaction offering the unique feature of the option to purchase. Article 22 is a daring synthesis of both the new definition of crédit-bail, expanding the reach of crédit-bail among the many constituencies of the Malagasy and international economies, and the expanded notion of property subject to crédit-bail, touching as this does on intra firm dynamics. As intended, Article 22 has the intent of focusing state property policies on the physical asset subject to lease, thus permitting investment in the option to purchase by Malagasy and foreigner alike, even if the property in question is land. This foresighted provision foresees the investment value in the option itself. This feat has yet to be accomplished by even the most progressive code jurisdictions dealing with leasing transactions. *See* FFL; BLO cited *supra*. It thereby removes crédit-bail from understandable but parochial concerns about state property policy and subjects the option to a universal market of investors, irrespective of nationality.

From the standpoint of universality in the Malagasy and international economies generally, Article 22 highlights that which is unique in the definition of crédit-bail and recognizes universal, marketable value in this uniqueness. From the standpoint of intra firm behavior it accords special status to a novel sort of intangible property secured by the *crédit preneur*, a marketable option to purchase. This can make the *crédit preneur* an entrepreneur. This happens by empowering the credit prenuer to leverage off the value of the option to purchase, by securing funds against the value of the option. The *crédit preneur* thereby has the potential not merely to use the asset in question, but to develop and improve it. The CRDA' s cumulative decisions have thus made crédit-bail more understandable and predictable through strengthening not only the institutional but the conceptual framework underlying the transaction.

In the aggregate, the decisions of CRDA have thus raised the understanding of the universal capacities of crédit-bail as an empowerment tool. But how does the transaction get started? This demands a consideration of the utility of third-party financing to crédit-bail.

B. Increasing Utility: The Synergies of a New Lender Community

Since the World Bank study of 1993, much has occurred to underline the lack of confidence in traditional bank capabilities for crédit-bail, if not suggest even further erosion in a bank's willingness or capacity to enter into a crédit-bail transaction. Through the innovations described in A *supra*, the CRDA has increased the understanding of crédit-bail's power to transform the economic landscape. But willingness is one thing, capability is another.

Phrased differently, a large part of the problem with the current legal regime for crédit-bail is its failure to address the inability of would-be *crédit bailleur*s to make acquisitions prior to consummation of the lease. Who are such potential *crédit bailleur*s? As is currently understood in Madagascar, these are banks. But there are several problems with this view. These problems, in truth, explain why crédit-bail is not used. Even Malagasy banks, to say nothing of foreign

banks, do not have sufficient knowledge of many potential *crédit preneur*s so as to engage directly in crédit-bail. Secondly, even if these banks had such knowledge, crédit-bail remains difficult. This is because, as *crédit bailleur*s, the banks would have to assume the direct responsibility of ownership and verifying the *crédit preneur*'s proper use of the property subject to lease. This requires an immense investment of bank resources, especially when the property in question is rolling stock, as is typical in a credit mobilier situation. Thirdly, foreign banks that might otherwise be a source of financing as *crédit bailleur*s in a credit immobilier situation cannot assume this responsibility due to severe restrictions on foreign land ownership.

Against the backdrop of these complications, months of both analytical and promotional work by the ARD/Cheechi/JURECO team has yielded the following profile of the present financial community:

- the above complications burdened banks as would be *crédit bailleur*s throughout the '90s (cf. IBRD Study, p.p. 152-55)

- while the increased access to capital that might inure to local banks as a result of increased foreign participation is a possible advantage, foreign participation is likely to make local banks quite conservative in defining the audience of potential crédit-bail users, thus depriving the transaction of the synergistic universality contemplated by many of the CRDA innovations described

- the handful of non-bank companies willing to do crédit-bail are severely constrained by lack of significant funds in house, with crédit-bail transactions contemplated in the low 100K range rather than in the range of 500K-950K, to say nothing of the capability of doing transactions in the range of 1,000, 000

In short, the legal innovations undertaken by CRDA to date may well make the financial community willing to undertake crédit-bail. But it will not make them capable of doing so.

What is necessary is draft legislation that extends the theme of empowerment to capability as well as willingness, to utility as well as understanding. The solution is to use a law to affirmatively encourage banks to be either *crédit bailleur*s *or financiers to crédit bailleurs*. In the latter case of third-party financing, the banks can avoid the above problems by lending to a party they may know who has either the resources to assess the *crédit preneur*'s use of the property leased or the legal capacity to take title to the property subject to lease. This solution will provide greater security for banks. It also has the additional economic advantage of creating a new class in commerce, the non-bank *crédit bailleur*, that can serve as an additional stimulus to the Malagasy economy.

Fortunately, the law can offer at least a significant partial solution to these problems. This is through recognizing the imperative of third-party financing as crucial to crédit-bail in Madagascar. Unfortunately, that solution is not provided in the current law on crédit-bail. The solution has the following attributes:

- *transparency* - explicit treatment of the possible conflict between the *crédit preneur* and the *crédit bailleur*'s financier in the text of a reform law on crédit-bail

- *clarity* - unambiguous recognition of the involvement of third-party financier as well as third-party suppliers as providing value to a crédit-bail transaction

- *decisiveness* - balancing the need to preserve the *crédit preneur*'s option to purchase against the inevitable claims of third-party financiers

As Annexes 2-3 make clear, draft Article 23, or language substantially similar to it incorporating the above attributes, was a foremost consideration of the team as it began considering the international standards for crédit-bail in late January. The international and economic concerns are hand-in-hand. This is because, as the history of the Malagasy financial community attests, much of the economic value needed to stimulate crédit-bail will likely come from third-party financing outside Madagascar. Without the clear guidance of legal authority, a would be third-party financier, especially one from outside the country, will perceive itself at considerable risk from the *crédit preneur*'s unique claims.

The CRDA's bringing extraordinary interdisciplinary as well as international resources to bear on this question evidences its commitment to positive resolution of this issue. This is consistent with its remarkable progress on the draft law to date. The merits for treatment of third-party finance in a reform law are manifest:

1. *Economic Urgency*

The team's survey of the financial community in Antananarivo suggests that banks are reluctant *crédit bailleur*s whose crédit-bail engagements would be selective at best and heavily tied to finance "on location" in and around the capital city. The engagement of traditional lenders in crédit-bail also suggests an orientation to heavy industry. Thus, the kinds of regional and cross-sectoral synergies associated with crédit-bail in a reform context will fall to non-bank *crédit bailleur*s, who would rely heavily on third-party financing. These findings conform to the World Bank analysis of the early '90s, for their conclusion that conventional banks are overburdened as it is with a multitude of other tasks. IBRD Study, p.p. 152-53. Moreover, a recent analysis undertaken in respect of Madagascar's capital markets strongly suggests that if banks were *crédit bailleur*s, the *crédit preneur*s would be industrial firms likely to receive bank loans in any case. Mourji, "Crédit-bail et autres innovations sur le marche financier, fevrier 2000" (Version Provisoire undertaken for Harvard Institute for International Development). What is needed is to stimulate a new class of non-bank *crédit bailleur* and there is only one tool: third-party financing. Adoption of language substantially similar to draft Article 23 does this.

2. Consistency with CRDA's Broad Policy Recommendations to Date

a. Option as essential to crédit-bail definition – Articles 1 and 2 as adopted by the CRDA place the option at the heart of the crédit-bail transaction. The same articles explicitly refer to the *crédit bailleur*'s acquisition of the asset subject to lease and thus the *sine qua non* of third parties

to the transaction. Preservation of the *crédit preneur*'s option to purchase must thus address a most likely threat to that option, the claims of third-party financiers against those of the *crédit preneur*. Adoption of language substantially similar to draft Article 23 does this.

b. Boldness and balance – As noted, the CRDA has adopted Articles 1 and 2 with a view to maximum autonomy for the *crédit preneur* but compensating security for the *crédit bailleur* in the form of recordation. This means protection against potential creditors of the *crédit preneur*. Symmetry therefore demands equal attention to the other side of the transaction, the existence of creditors of the *crédit bailleur* and similar security accorded the *crédit preneur*. Full symmetrical treatment can only be accorded in one way: an explicit textual provision in the reform law on crédit-bail defining the *crédit preneur*'s position relative to a third-party financier of the *crédit bailleur*. Adoption of language substantially similar to draft Article 23 does this.

3. Consistency with CRDA's Textual Recommendations to Date

a. Article 5 – As adopted by the CRDA, this Article was carefully analyzed in committee session on February 10 and defines the rights of the *crédit preneur* versus those of a third-party supplier. It effectively enables the *crédit preneur* to assert rights directly against the supplier, without interference from the *crédit bailleur*. In the same spirit, draft Article 23 as submitted by the team safeguards the rights of the *crédit bailleur* against all third parties, financiers as well as suppliers. By adoption of Article 5 the CRDA recognized the importance of clarifying the rights of the credit prenuer *vis a vis* a third-party supplier, who may not even remain in the crédit-bail transaction after having been paid on delivery. *A fortiorari*, a reform law on crédit-bail should accord the same importance to third-party financiers, whose contractual relations with the *crédit bailleur* are likely to extend over the life of the lease and perhaps longer. Adoption of language substantially similar to draft Article 23 does this.

b. Article 12 – This Article concerns recordation rights in a typical three-party crédit mobilier situation. Consistent with the analysis of the importance of third-party financiers as well as suppliers above, Article 12 foresees the presence of many types of interested third-parties who have a reliance interest equal to that of the *crédit bailleur* in seeing to recordation of an interest in the asset subject to lease. The language of Article 12 is deliberately broad to accommodate third-party financiers as well as third-party suppliers. If such third parties can act to effect recordation and thereby assert a right also accorded to the *crédit bailleur*, surely symmetry and equity demand that the *crédit preneur* has a similar interest in being able to assert the rights the *crédit bailleur* has against a third-party. Adoption of language substantially similar to draft Article 23 does this.

4. *Conformity to Malagasy Legal Practice*

The Malagasy legal tradition is to treat the complex issue of third-party rights in the explicit text of a law. For example, Law 66 "On the General Theory of Obligations" does this throughout. There is virtually no reliance by this law on Malagasy common law ("droit commun") due to the potential complexity of the transactions involved. Rather, third-party rights are set forth in text. Having introduced the unique option to purchase as, by definition, the unique aspect of crédit-bail, a reform text on crédit-bail should thus indicate the parameters under which the option to

purchase is protected against third-party claims. Adoption of language substantially similar to draft Article 23 does this.

5. *Conformity to International Legal Trends*

As noted in Part II *supra*, progressive Continental code jurisdictions with significant economies in transition are moving to explicit recognition of third-party rights and claims in the text of leasing and crédit-bail legislation. In addition, recent industry wide international standards not only recognize third-party rights and claims, they have clarification of same as their *raison d'etre*. Prelude to the Unidroit Convention on International Financial Leasing, International Institute for the Unification of Private Law, Articles 1 and 6. Adoption of language substantially similar to draft Article 23 does this.

Weighed against these factors are observations that the third-party finance issue be left to private contract. Or that Madagascar's common law ("droit commun") settles the issue. Both points mistake the issue. The would be *crédit bailleur*, who must rely on third-party funding, contracts with no one if he does not secure it. The point as to droit commun similarly assumes the presence of economic resources for crédit-bail that do not in fact exist. The bedrock of droit commun is practical experience but the lack of resources precludes any experience, and hence any resort to droit commun for crédit-bail purposes.

As noted, the CRDA has to date stopped short of adoption of draft Article 23. Adoption would be more consistent with the reform philosophy CRDA has otherwise followed. At the same time, the team commends the CRDA overall disposition of this matter given institutional constraints. The question, of its very nature, is one that goes to the heart of economic policy in its implication of such issues as the development of the banking sector, risks taken by non-bank financial institutions and the role of foreign investment in the Malagasy economy. Seen in this light, the CRDA' s decision on March 9 to "suspend" consideration of the draft Article and thereby defer the question for possible consideration by a forum devoted to a consideration of the broader economic consequences is entirely justifiable. In fact, it portends well for the arguments made above. The team was most encouraged by the tenor and structure of the March 23 meeting. There, the CRDA accorded the team's international specialist and management great deference in explaining the importance of the draft Article. Further, this explanation was before a group of policy-makers outside CRDA who will likely comprise this broader policy forum. Most importantly, the team is greatly pleased, and in fact flattered, that the question had shared the agenda with the consideration of crédit-bail's implications for taxation and finance, thus underlining that the issues raised by draft Article 23 are of equal dignity with these momentous questions of government policy.

It is safe to say that such a broad consideration of the economic dimensions of commercial legislation would have been impractical, if not unimaginable, prior to the emergence of the CRDA. The team therefore salutes this milestone in CRDA deliberations and was delighted to have played a central role in same.

It is important to note that the discussion above has proceeded almost entirely in terms of technical analysis. But thought must also be given to strategy as well as analysis. There is a

need to gain broad-based support for a reform law on crédit-bail. Here, the utility issue can be a great tool for securing broad-based support from all sectors of the business and consumer communities. Explicit treatment of the financing for crédit-bail in the law breathes life into the transaction. It makes crédit-bail palpable to the public. It builds momentum. To say to an entrepreneur or a firm that a clearer, more understandable legal regime for crédit-bail has been created is one thing. To say to that same person or firm that the law leads the way to secure money to do the transaction elicits a much more enthusiastic response.

It remains to discuss both how this momentum can be sustained and to treat the types of legal authority necessary to support a new reform crédit-bail law. The two themes are intertwined, and can be used to mutual advantage, as the ARD/Cheechi/JURECO team will now relate.

IV. Sustaining Momentum: Reform Crédit-bail in the Malagasy Policy Constellation

The CRDA has demonstrated diligent concern as to those issues that will have to be addressed to facilitate a reform law on crédit-bail. The ARD/Checchi/JURECO team has worked closely with the CRDA to anticipate these developments. If properly understood in strategic terms, the amendment of laws, regulations and policies connected to crédit-bail can be far more than a dry exercise. Instead, it can become an instrument to expand support both from within the government and the private sector for the transaction.

As we have related in Part II, universality is the international theme of crédit-bail, from a firm as well as from a macroeconomic standpoint. Part III A and B focused on the issues of greatest importance in the current profile of the Malagasy business community, with respect to increased understanding of and utility for the transaction. Consistent with the reasoning already expressed, momentum among the economic constituencies may develop on the model of an "inverted pyramid", first focusing on developing broad support and then leveraging off the goodwill and political capital so developed to aim at the development of market friendly regulation of the transaction among particular regulatory bodies in the Malagasy government.

A time table for directed action, aimed first at broad and then at narrow constituencies, proceeds as follows:

January – June 2000

1. Third-Party Financing – CRDA has taken the lead in giving public voice to this vital issue. This paramount practical issue must be resolved to secure the broad attention of the consumer and financial communities. Because there is no business tradition for crédit-bail, its resolution in a transparent legal text is the best and probably the only way of convincing a broad segment of the public of the credibility of the transaction. General efforts at persuasion and marketing are helpful but carry no authoritative force. In a business climate fraught with skepticism, legal authority is essential for developing the new class of *crédit bailleur* necessary by convincing the

business community that third-party financing will come and that crédit-bail is realistic. The CRDA, the National Assembly and other responsible government officials should:

- incorporate and adopt draft Article 23(or language substantially similar) into a reform law on crédit-bail; AND

- amend complementary authority on recordation of crédit-bail interests such as the decree on recordation of credit mobilier to: (a) refer expressly to the date of expiration of the lease as a matter to be explicitly recorded in a crédit-bail transaction; (b) require the *crédit bailleur* to list all third parties having a claim against the *crédit bailleur* by virtue of supplying the asset subject to lease or the financing of same; (c) consistent with Article 12 of the draft text approved by CRDA, permit interested parties other than the *crédit bailleur* and the *crédit preneur* to record same interests

Both steps are important – no one can substitute for the other.

2. Licensing - Once the third-party financing issue is institutionalized in the law, crédit-bail as a transaction becomes a reality. The base of the pyramid of popular support is solidified as would be *crédit preneur*s, *crédit bailleur*s and third-party financiers see the transaction as a reality. Implementation strategy then proceeds down the inverted pyramid to focus on regulation of the universal class of *crédit bailleur*s. This means that crédit-bail should secure the special attention of the Commission de Supervision Bancaire et Financiere (CSBF).

This should not be difficult. The CSBF has followed the discussions of CRDA on crédit-bail and already made valuable input. This suggests a great willingness to reexamine CSBF licensing regulations in the event of any realistic possibility of a reform law on crédit-bail. CSBF already has some regulation in place to accommodate *crédit bailleur*s. What is necessary is revised regulation to take into account the needed new class of *crédit bailleur* that can be created by third-party finance. The profile of this new class is: non-bank, small to medium-sized business specialized in crédit-bail alone, and local. Given these new dimensions, serious consideration should be given to revised licensing requirements that first permit the expansion of this class. A revised licensing policy would include:

- an official statement by CSBF that the CSBF is the exclusive regulatory body governing crédit-bail and that in so regulating, the CSBF will not invalidate any crédit-bail transaction

- the development of an amended application form for credit establishments so as to permit applicants to explicitly indicate (via check box) that they will engage in crédit-bail as a *crédit bailleur*, along with a commitment by CSBF as the regulatory body to process all such applications within thirty (30) days of receipt

- the development of a formal written response to applicants in the event that an application is inadequate, along with a formal commitment by CSBF that it is bound by such a statement

- the development of a formal hearing process, involving the CSBF and the applicant in the event the application for *crédit bailleur* status is rejected a second time

- a commitment by CSBF to regulatory amnesty on crédit-bail for the first twenty-four (24) months following the enactment of a new law on crédit-bail, during which amnesty period any firm engaged as a *crédit bailleur* would not be penalized by CSBF through revocation of the license for crédit-bail or any other means but would rather be subject to probation

- the development of the relation between the CSBF and the *crédit bailleur* during the probationary period, the philosophy of which is education of the *crédit bailleur* in question not punishment, which probationary period might include special semi-annual reporting procedures and audits by CSBF during the probationary period to ensure compliance with CSBF requirements

- explicit commitment that permits all entities engaged as *crédit bailleur*s to obtain financing in foreign currency, to the extent that any controlling legal authority at the moment might be read to the contrary

The aim of all licensing regulation in this area is to encourage the crédit-bail transaction through encouraging the fragile, new class of *crédit bailleur*.

Thus, in the six-month period beginning in 2000, Madagascar will have given priority to the legal framework for crédit-bail, both in the context of law and regulation.

January 2000-December 2001

3. Accounting – In terms of the base of the pyramid, accounting should be accorded a priority nearly equal to the development of a reform law. Accounting issues similarly touch all of constituencies affected by crédit-bail. Phrased differently, accounting will be the language through which all the constituencies involved in crédit-bail memorialize a given transaction in business terms. The team is encouraged that the CRDA has given special attention to the importance of the accounting profession in this area. The team is even more enthusiastic that CRDA is following up on the team recommendation for an "accounting summit" on crédit-bail to be composed not only of representatives of the CSBF and bank auditing authorities, but also of the Conseil Superieur and private sector representatives.

Indeed, more time has to be allocated for the development of accounting standards than for the actual text of a reform crédit-bail law. Among the reasons are: the need to integrate Malagasy accounting standards on crédit-bail questions with the standards of foreign banks and foreign bank auditors and the virtual absence of concrete, useable references to crédit-bail in the national accounting plan of 1987. Major accounting issues are likely to focus on:

- amortization methods referenced against types of property subject to lease

- income reporting, especially as to lease payments to the *crédit bailleur*

- adjustments in accounting upon the credit prenuer's exercise of the option to purchase at the expiration of the lease

While these technical aspects are important, the team is confident that they will be resolved in accordance with international standards. **Of equal importance to the "what" of the standards is the "how" in their formulation.** It is vitally important that regulatory authorities, particularly in the tax area, work in a constructive partnering relationship with private sector representatives to ensure the development of accounting standards that are not only transparent but useable and realistic for the Malagasy financial and business communities. At the same time, standards must be imposed and anarchy cannot prevail. The team is most encouraged that the CRDA's draft text has adopted the appropriate posture here, reflecting a position that leaves accounting to accountants and their regulators. (This is to be contrasted with the unfortunate state of the current law, Articles 64 and 67 of which might be read to hand a *carte blanche* to accountants in reporting on crédit-bail transactions). Accounting, like any language, needs a grammar. The team believes it most important for the partnering of the business and regulatory communities to continue at least one year from the inception of crédit-bail transactions to ensure that the grammar is useable. This will facilitate monitoring.

June 2000-June 2002

4. Customs – Priorities 1-3 *supra* addressed the universal audiences for crédit-bail, both the two immediate parties to the transaction and vitally important third parties. Not coincidentally, these issues also ensure that the transaction can work by reflecting the business interests of all concerned. As the pyramid narrows, the focus becomes on those issues of most immediate concern to *crédit preneur* and *crédit bailleur*. Because customs issues focus on the basic value of the asset subject to lease, they are more subject to easy resolution than income tax implications. A host of questions will likely focus on:

- whether assets subject to crédit-bail should be initially exempt on import from customs duties

- administrative collection efforts once allocation of responsibility for payment is fixed between *crédit bailleur* and *crédit preneur* (i.e., whether customs officials may proceed against the *crédit preneur* and *crédit bailleur* jointly and severally for the total amount of customs duty due)

- whether on re export of the asset subject to lease, the customs duty originally assessed is subject to rebate

It is vitally important to examine crédit-bail in the context of Madagascar's current customs regime, including the treatment of crédit-bail by the customs regimes of other countries with which Madagascar enjoys or seeks to enjoy a special customs union. However, the team encourages openness to the idea that customs authorities defer to contract terms between *crédit bailleur* and *crédit preneur* on these issues. This would be most conducive to letting the transaction develop. The Romanian decision cited in Part II *supra* to forego imposition of

customs duties upon import, for example, is consistent with this philosophy. Thereafter, Madagascar might impose standards that parallel those of the international community.

5. Income and Corporate Taxation – As the team and other consultants have reported to CRDA on multiple occasions, the prime motive for leasing transactions in many advanced countries is tax advantage. The proper tax code can create a favorable climate for crédit-bail. But hastily formulated regulations, created with the view that the public fisc be the unidentified beneficiary of a crédit-bail transaction, will have a catastrophic, chilling effect on the crédit-bail transaction as an empowerment tool.

Hence, the team recommends a moratorium on tax regulation explicitly aimed at crédit-bail for a period of twenty-four (24) months from enactment of a new law on crédit-bail. This will give tax authorities time to work with private sector representatives on accounting standards. It will more importantly give authorities time to analyze the effects of the transaction on the economy. This, of course, is not to say that crédit-bail is not a taxable event. During the period of moratorium, tax officials should develop simple guidelines on various aspects of crédit-bail that find analogies to the current working tax code. Among these are:

- currently acceptable depreciation practices for capital and other goods and the implications of same for amortization in a crédit-bail context (e.g., straight-line versus accelerated depreciation)

- currently practiced apportionment of payments to a crédit-bailleur to income on one hand and capital investment on the other and the implementation of same as to crédit-bail

The CRDA has in many contexts acted decisively to accord crédit-bail special status as an empowerment tool with a universal appeal. But, in the spirit of reform already initiated by CRDA, more is needed. This starts with a frank admission of the importance of third-party financing to the transaction and the importance of the law in advancing same. This done, the pyramid is expanded; the legal and regulatory implementation of the transaction assumes a dynamic quite beyond a sterile exercise in the drafting of compatible legal authority. Implementation rather becomes an exercise in reinforcement of the mutually dependent constituencies, from Wall Street to the Malagasy Main Street to its countryside. The five-step approach above will energize existing segments of the Malagasy economy. But it will transcend this to create new economic constituencies based on the exciting possibility for a new brand of Malagasy *crédit bailleur*. *This new crédit bailleur will be one much closer to household and small business echelons than the crédit bailleur of the current legal model.* Let the motto be: empower those in special need of it. Only then can crédit-bail in Madagascar reach its genuine, rich potential, a potential well within reach thanks to the CRDA's foresighted initiatives to date.

ANNEX I

DRAFT LAW ON CREDIT- BAIL

(The text below is an unofficial translation in English of those Articles of a reform Draft Law on Credit-Bail as accepted and reported by the CRDA as of April 5, 2000. Some overlap appears in numeration of Articles and this numbering will be reconciled upon integration of a final text in a subsequent reporting of the CRDA secretary)

General Provisions – Definitions

Art. 1: Crédit-bail is a contract by which an individual, the *crédit bailleur* or lessor, puts at the disposal of another individual, the *crédit preneur* or lessee, in a return for (rent) payment, for a determined period of time, at the end of which the lessor gives the opportunity to the lessee to purchase all or part of the asset leased.

Art. 2: The asset that is the subject of crédit-bail is acquired from a third party or the lessor himself by the *crédit bailleur* (lessor) at the *crédit preneur*'s request and in accordance with the latter's instructions.

Art. 3: The *crédit bailleur* can be only a credit institution subjected to the provisions of Law n° 95-030 of 22 February 1996 related to the activity and monitoring of credit institutions.

Any individual who, working on his own account or for a firm, and practices the activities defined in Article 4 hereafter, without conforming to the provisions of above-mentioned Law n°95-030, is liable to penalties provided in said law.

On Crédit-bail Transactions: determination – Operation

Art. 4: Pursuant to Articles 1-2 above, the following are qualified as crédit-bail (leasing) transactions:

1. Lease operations of personal property, capital equipment or materials, purchased in view of this lease by firms who remain their proprietors, whatever their qualification, give to the lessor the possibility to acquire all or part of the leased goods, in return of a price set in advance or that can be determined according to a calculation stipulated in the contract that takes into account payments effected as rents;

2. Lease operations of real estate for professional use carried out by a firm, the said properties being purchased or built personally, when these operations, whatever their qualification, allow the lessee to become proprietors of all or part of the leased goods, at the latest at the expiration of the lease. Access to the property of all or part of leased goods is done by cession, in execution of an unilateral sale promise, either by direct or indirect

acquisition of land property rights over buildings constructed on the land owned by said lessee.

3. Crédit-bail operations for businesses, handicraft establishments or one of their intangible elements with an unilateral promise of sale in return of an agreed price, taking account of payments, effected as rents, other than all crédit-bail operations to former business or handicraft establishment owners.

Art. 5: Pursuant to a clause of the crédit-bail contract, the bailleur and the lessee can agree with the vendor that the lessor will act directly in guarantee against the vendor because of the obligations from the sale.
This clause proves renunciation from the lessor of the legal guarantee of the bailleur.

Art. 6: In the event of cession of goods which is part of a crédit-bail operation, and during the operation period, the transferee is liable to the same obligations as the transferor who is still responsible for it.

Art. 7: The crédit-bail convention does not concern the statute of commercial leases.

Art. 8: The crédit-bail contract envisages the conditions under which its cancellation will, if need be, intervene at the preneur's request. The *crédit preneur* can, after having given notice to the *crédit bailleur*, consider crédit-bail as revoked if the good is not delivered to him within the time envisaged in the contract or within the period allowed in the formal notice.

Art. 8bis: In the event of a dispute on the validity or the execution of the sale contract the court cannot suspend the execution of the credit contract.

When the crédit-bailleur left to the authority, the resolution or the cancellation of the sale contract leads automatically to the cancellation of the credit contract.

If the resolution or the cancellation of the sale contract occurs because of the vendor, he will, at the *crédit bailleur*'s request, be liable to the *crédit preneur* to refund the loan, without damage prejudice to the *crédit bailleur* and the *crédit preneur*.

Art. 8ter: In the event the lessor fails in the obligations and after a formal notice by way of writ of a bailiff he remain in a period of time of 15 days, the crédit-bail is automatically canceled without damage prejudice payment of rent arrears and of damages.

The judge can, even automatically, moderate the penalty envisaged by the parties if it is obviously excessive. Any stipulation of the contrary is not valid unless written.

The bankruptcy or the setting in judicial resolution of the lessor constitutes a cause of automatic cancellation of the contract.

On Advertising Crédit-Bail Operations

Art. 9: The crédit-bail operations in Article 4 above are required to being advertised in a way which must allow to identify of the parties and the goods which are the subject of the aforesaid operations. The various methods of this advertisement are fixed in Articles 10-20 hereafter.

Common provisions, Accounting Advertising

Art. 10: Without prejudicing Article 66 of Law n° 95-030 of 22 February 1996 concerning the activity and control of credit institutions, the business corporations, which resort to crédit-bail operation to acquire equipment, materials or buildings for professional use, are required to mention in the Appendix envisaged by the Articles 3.1 and 3.2 of the Commercial Code in result of Law 99.018 of 2 August 1999 concerning the Tradesman Law, the following information:

1. the value of these goods at the time of the contract signing;

2. the amount of rents related with the exercise as well as the cumulated amount of rents of the proceeding exercises

3. the evaluation at the closing date of the remaining assessment of the rents to pay as well as residual purchase price of these goods stipulated in the contract.

Art. 11 : The legal entities other than those aimed at in the preceding article and the physical person qualified as tradesman must:

1. reveal separately in their income statement the rents corresponding to the execution of the contracts relating to the above mentioned operations, by distinguishing the operations from real property crédit-bail operations and the equipment crédit-bail operations.

2. evaluate in the appendix and at the closing date of the assessment the total amount of the remaining rents to be supported pursuant to the obligations stipulated in one or more crédit-bail contracts by distinguishing the crédit-bail operations from real property crédit-bail operations and equipment crédit-bail operations.

Personal Property Crédit-Bail

Art. 12: The information concerning the crédit-bail operations in matter of property are published, at the request of the crédit-bail company or any interested person, according to the methods envisaged in the following article.

Art. 13: The publication is required at the clerk's office of the concerned court of which the credit-preneur is registered in principal with the trade register.

Are considered applicable the provisions of Articles 18 and 19 concerning the recording of crédit-bail contracts of Decree 99-717 of September 8, 1999 on advertising real property crédit-bail.

If the *crédit preneur* is not required to register with the trade register, the publication is required at the Clerk's office of the high court (Tribunal de première instance) which has jurisdiction over the location of the establishment for the needs of which it subscribed crédit-bail.

The methods of this publication will be the subject of regulations.

The registration, regularly carried out, is opposable to the parties and the third parties, beginning the date of registration of the company with the trade register, for five years, except in cases of renewal. The conditions of the registration as well as its renewal obey the provisions of Articles 21 and 22 of Decree 99-717 of September 8, 1999 on the advertisement of personal property crédit-bail.

Art. 14 : Any modification assigning the information mentioned in Article 12 is published in the margin of the existing inscription.

The registrations regularly carried out pursuant to Article 13 and to Subparagraph 1 above take effect on their date. They are expunged on the initiative of the crédit-bailleur or the credit-preneur, either on justification of the agreement of the parties, or under the terms of a judgement or of an order passed in force of decision.

Art. 15: The Clerk delivers to any applicant, copies or extract of the publication statement if they mention the transfers or the modifying inscriptions.

Art. 16: The supporting documents which must be presented to the clerk of office, as well as the methods of publication or radiation and the models of application forms, copies or extracts are those envisaged, according to the case, to Articles 18 and 23 of decree 99-717 of 8 September 1999 on the advertisement on personal property crédit-bail.

Art. 17: Failure to advertise leads to the non-invocability to third parties of crédit-bail rights of the company on the property over which it holds its rights, except if it mentions that the concerned parties had been informed of the existence of these rights.

Real Property Crédit-Bail

Art. 18: The real property crédit-bail is subjected to a land advertisement in the forms and conditions envisaged by Ordinance n° 60-146 of 3 October 1960 on the registration of land tenure.
In the absence of advertisement, the provisions of Article 17 above are applicable.

Art. 19: Any infringement to the provisions of Articles 10 and 11 will result in a fine in the amount of ten to one hundred million FMG.

Art. 20: Chapter 4 of the law n° 95-030 concerning the activity and the control of the credit institutions is repealed.

Art. 21: The present law will be published in the Official Journal.

It will be carried out as a Law of the State.

International Crédit-Bail

Art. 21: Is considered international the crédit-bail where the *crédit bailleur* and the *crédit preneur* have their establishment located in different States

The establishment understood within the meaning of the subparagraph above indicates, if one of the parties to the crédit-bail operation has more than one establishment, the establishment which has the closest relation to the contract in question with regard to the known circumstances of the parties or under consideration by them at an unspecified time before the signing or at the time of the contract signing.

Art. 22: The respective rights of the *crédit bailleur* and the holders of a real right on the good subject of crédit-bail are governed by the law of the State where the good is located.

Art. 24: The transfer of goods included in the crédit-bail operation can be carried out by crédit-bail to the benefit of any person or legal entity in respect to the legal provisions in force on the territory of Madagascar.

CRDA has suspended the work on the draft Article 23. The draft submitted by the ARD/Checchi/JURECO team is as follows:

Art. 23: Parties, other than the *crédit bailleur* and the *crédit preneur*, who have permitted the realization of the crédit-bail operation and whose intervention is proven by the very exact terms of the contract or by the negotiations may not hold related rights and obligations, unless in one of the following situations:

a) the person is a contractual relationship either with the *crédit preneur* or with the with the *crédit bailleur* in order to facilitate the crédit-bail operation
b) the person has delivered the object of the crédit-bail operation
c) the person has carried out any action related to the terms of the crédit-bail contract between the *crédit bailleur* and the *crédit preneur*.

ANNEX II

Weeks of February 7 and 14 (Team Discussion)

(This Annex is presented primarily for archival purposes. It represents discussions and research within the ARD/Checchi/ JURECO team for the weeks in question. References to the December draft are to the draft of Articles 1-21 as presented by JURECO to CRDA in early February, 2000. Draft Article 23 appears in gestation in the form of Article 6.)

General Definitions

Article 1 The crédit-bail is a transaction realized by a lease between two entities, the crédit-bailleur who provides an asset , or the means to acquiring same through financing, to a renter, or *crédit preneur*, for a determinate period of time by way of lease, at the expiration of which the *crédit preneur* has the option to purchase the asset subject to lease. This option is a present right to future purchase as of the date of said lease and is a right to purchase such interest as a party other than the *crédit preneur* has in the asset leased.

Annotation: This draft article combines the approaches of Articles 1 and 2 of the December draft but takes further account of international standards. Consistent with the modern practice of a finance lease, the *crédit bailleur* may either provide the asset subject to lease or provide the financing, the means to acquire same. Article 73 of the present law of crédit-bail in Chapter IV of Droit Bancaire only contemplates that the *crédit preneur*, not the *crédit bailleur*, may be involved in the obligations attending financing (law on crédit-bail hereinafter cited as D.B). By contrast, under modern international leasing practice, the *crédit bailleur* may in fact be in the role of a financier rather than in the traditional role of a party having permanent and standing title and control over the asset subject to lease. Thus, such asset as the *crédit preneur* desires to purchase may or may not have been in the full ownership and control of the *crédit bailleur*. Cf. Uniform Commercial Code Article 2A (1990) (Uniform Law Commissioners and American Law Institute) (hereafter referred to as UCC Art. 2A). The international financial community needs to be immediately certain of the nature of the right to purchase the asset subject to lease, when it commences and its enforceability. The December draft refers to the grant of a "possibilite", whereas this elaborative text clarifies that the option is something of value at the time of the contract. This enhances the liquidity of the option, the right to purchase, in international markets.

Article 2 Parties other than the *crédit bailleur* and the *crédit preneur* may have an interest in the asset subject to lease, as parties to contracts for financing the acquisition of same by the *crédit preneur*, the *crédit bailleur* or otherwise. Such rights as other parties may have are by virtue of several sources, including but not limited to:

- mortgage, pledge or other security interest the asset subject to crédit-bail or the proceeds from such asset;

- mortgage, pledge or other security interest in property other than the asset subject to crédit-bail;

- documents or a course of dealing that give such other parties an interest in performance by the *crédit preneur* in the obligation under the crédit-bail or set forth the asset subject to crédit-bail

Upon determination that a transaction is a crédit-bail, the rights of such parties shall not qualify the right of the *crédit preneur* to purchase the asset subject to lease. Nothing herein shall qualify the right of such parties to take a security interest in said right to purchase.

Annotation: International commercial practice demands a prompt and direct textual reference to the commercial reality of crédit-bail as effectively a three party transaction involving financing through the *crédit bailleur*. The Prelude to the Unidroit Convention in International Financial Leasing, International Institute for the Unification of Private Law (hereinafter referred to as UNIDROIT) immediately acknowledges that leasing is often a "distinctive triangular relationship." The explanation prefacing the December draft stipulates this but then largely proceeds to treat crédit-bail as a two party transaction, as does Article 66 of the D.B.

This draft article takes into account the range of commercial configurations contemplated by international commercial practice. In fact, the *crédit bailleur* may be the supplier of equipment in a finance lease (see UCC Art 2A) or the financier of a construction project in which the *crédit preneur* is already the owner of the property subject to lease, as the preface to the December draft notes. This draft article takes into account these possibilities and others. See Annotation to draft Article 6 *infra*.

Article 3 During the period of the lease, the *crédit preneur* has the right to full enjoyment of the asset subject to lease, including the right to be free from claims of parties other than the *crédit bailleur*. The *crédit bailleur* shall undertake all measures to secure the full enjoyment of the credit prenuer in the asset during this period. Unless otherwise stipulated by the *crédit bailleur* and the *crédit preneur*, the option to purchase the asset subject to lease shall mean that as of the time of the lease and until exercise of the right to purchase:

(i) as to the asset subject to lease provided by the *crédit bailleur*, the *crédit bailleur* has full title and ownership interest in same and that same shall continue until exercise of the option to purchase by the *crédit preneur* under the contract;

(ii) as to the asset subject to lease acquired through financing provided by the *crédit bailleur*, the *crédit bailleur* shall take all actions necessary to ensure that the *crédit preneur* shall, through exercise of the option to purchase, acquire full title and ownership, including but not limited to such acts by the *crédit bailleur* as are necessary to secure such right to full title and ownership and the *crédit bailleur* shall refrain from such unilateral actions as will encumber full title and ownership by *crédit preneur* upon exercise of such option.

Pursuant to the obligations of the *crédit bailleur* as set forth above, for the duration of the lease, the right of the *crédit preneur* to purchase of the asset subject to the lease shall be subject to

only those claims and defenses as arise from: (1) a breach of lease by the *crédit preneur* and (2) a breach of the terms of any document enabling the *crédit preneur* to exercise the lease, including but not limited to any agreement between a *crédit bailleur* and the *crédit preneur* to secure financing of the lease or the acquisition of the asset subject to the right of purchase.

Nothing herein shall be construed to limit the terms of contract between the *crédit bailleur* and any party to an arrangement to finance the acquisition of the asset subject to the lease or to otherwise facilitate a transaction of crédit-bail.

Annotation: Insofar as the *crédit bailleur* physically or as a matter of contract provides the asset subject to lease, the obligations in (i) of this Article are consistent with the international standards of UNIDROIT, Article 8, subarticles 2 and 4. But issues of the *crédit bailleur*'s ownership, possession and control of the asset subject to lease are subject to the subtleties of local property laws. The modern trend is that the *crédit bailleur*'s physical control and possession are less relevant. Insofar as the *crédit bailleur* is not in control of the asset subject to exercise of the right purchase, the obligations in (ii) of this draft Article acknowledge modern commercial realities by stopping short of requiring that the *crédit bailleur* to make representations and warranties as to title and ownership interest. This is frequently the case in the instance of a finance lease, when the *crédit bailleur*, as lessor, merely finances the acquisition of equipment and does not physically take control of it. (see UCC, Art. 2A). The preface to the December draft seems to recognize this as a typical credit mobilier situation. Accordingly, this draft acknowledges that in cases where the *crédit bailleur* has or may have no actual control over equipment or goods subject to lease, the *crédit bailleur* merely assumes responsibility for ensuring that the *crédit bailleur* will not adversely affect the right of the *crédit preneur* to purchase equipment or goods supplied.

Des Operations du Crédit-Bail: Détermination-Exécution

Article 4 During the term of the lease, only the *crédit preneur* may transfer the asset subject to lease. Such transfer shall obligate the transferee to the crédit-bail under the terms of the lease, while the *crédit preneur* shall remain liable as guarantor. Transfer of the right to purchase the asset subject to crédit-bail may be made to any physical or legal person, notwithstanding any limits under law on the capacity of said transferee to eventually assume title and ownership of such asset.

Annotation: This draft incorporates Article 6 of the December draft but takes into account international practices. Article 3 of UNIDROIT foresees value not only in the physical asset subject to lease but the value of the option itself. Insofar as this international practice recognizes value in the right to purchase the asset subject to lease, the revised law on crédit-bail should recognize that this right may be transferred to domestic or foreign financiers who have no intention of actually owing the property subject to this right but will raise capital based on selling a package of rights to purchase so as to minimize the risk of any single crédit-bail. *Cf.* World Bank Country Study, International Bank for Reconstruction and Development, p.p. 127-29 (1993) (elaborating on economics of risk allocation).

Article 5 The right to purchase the asset subject to lease shall mean the option of the *crédit preneur* to take full ownership and title and shall not be construed by this law to empower the credit prenuer, upon expiration of the lease, to continue the lease, to mortgage or hypothecate said right or to otherwise encumber the interest of the *crédit bailleur* in said asset. Such right shall be freely alienable and transferable by the credit prenuer at any time.

For the duration of the lease, the right to purchase the asset subject to lease is subject and limited to, and coextensive with, such defenses and claims as exist against the asset subject to lease, including but not limited to defenses and claims arising from a failure to record the interests of the *crédit preneur* in the said right to purchase and the asset subject to lease as required by law. The *crédit bailleur* has the obligations set forth in Article 3.

Upon expiration of the lease and presentation of the opportunity of the *crédit preneur* to exercise of said right to purchase the asset subject to lease, said right shall not be subject to claims and defenses against the asset that could otherwise be maintained or asserted by the *crédit bailleur*. The obligations of *crédit bailleur* as set forth in Article 3 shall terminate upon the expiration of the lease, except as to claims of parties arising before the exercise of said right of purchase by the *crédit preneur*.

Annotation: This Article touches two points, both of which relate to the intersection of local law and international practices. It does not appear clear in the Malagasy law of property whether the grant of a full property right in the future implies a lesser right to rent or hypothecate the property in the future. This draft Article intends to resolve the situation by establishing the norm that the *crédit preneur* has only the right of purchase at the expiration of the lease. This is in conformity the outline of expectations in a modern commercial setting, as set forth in UNIDROIT, Article 9, subarticle 2.

The second of the two points is crucial. It concerns the juridical status of the right of purchase of the asset subject to lease itself at the moment the lease is terminated. Again, there is little offering affirmative guidance in Malagasy law on this point. While this point is subject to less explicit international commentary, it is vitally important to the viability of the right to purchase as a commercial tool. It is essential that the *crédit preneur*, at the time of the execution of the lease, have the assurance that nothing in Malagasy law will impede the eventual exercise of the right to purchase upon expiration of the lease. While UNIDROIT does not explicitly treat this issue, UNIDROIT Article 12, subarticles 1-2 sets forth the general principle that when the terms of the lease do not control, the terms of related contracts or the course of dealing between *crédit bailleur* and *crédit preneur* should. This justifies imposing on the *crédit bailleur* only minimal continuing obligations upon expiration of the lease and the ensuing opportunity for exercise of the right to purchase, which minimal obligations relate only as to claims the basis for which arose during the lease period.

Article 6 Parties other than the *crédit bailleur* and the *crédit preneur*, thorough the provision of financing or anything else of value, without which a transaction of crédit-bail would not be effected, as evidenced by the terms of contract or course of dealing, are held to have knowledge of, and be subject to the defenses arising from, the lease between the *crédit bailleur* and the *crédit preneur*, only in the event of one or more of the following circumstances:

(i) such third party is a party to the terms of a contract with either the *crédit bailleur* or the *crédit preneur* for financing or other means of facilitating the crédit-bail;

(ii) such third party effects physical or legal delivery to either the *crédit bailleur* or the *crédit preneur* of the asset subject to lease or anything of value, including any delivery to a *crédit bailleur* or *crédit preneur* with whom such third party enjoys no privity of contract;

(iii) such third party undertakes any other action consistent with knowledge of the terms of the lease between the *crédit bailleur* and the *crédit preneur*, including but not limited to the act of accepting payments under the terms of a contract of financing or other contract facilitating the crédit-bail

The above applies to obligate such third party under the circumstances stipulated, notwithstanding the failure of any party to properly record any document in question as required by law.

Annotation: As the prelude to the December draft suggests, the *crédit bailleur* may deliver either financing, the asset subject to the lease or both. These possibilities imply the role of third parties in crédit-bail. This draft Article elaborates upon Article 5 of the December draft in view of international practices. As suggested by Article 1, subarticles 1-2 of UNIDROIT, the equipment supplier may exist in privity of contract with the *crédit bailleur* only, with the former providing the asset subject to lease and the latter primarily the financing. Article 5 of the December 5 draft sets forth the general understanding of supplier liability to the *crédit bailleur*. This draft elaborates on this principle, taking into account the reality, reflected in both Article 1 of UNIDROIT and UCC, Article 2 A, that physical control by the *crédit bailleur* is less determinative of obligation than the performance of acts by third-party suppliers such as the transmittal of funds and the receipt of financing payments from the *crédit bailleur*. In addition to the equipment supply situation, this draft Article also covers a situation whereby the third party is not a supplier of equipment but a financial institution holding a mortgage executed by the *crédit preneur* on real estate leased by the *crédit bailleur*. No present provision of Malagasy law covers both these mobilier and immoblier contexts, as they are outlined in the prelude to the December draft.

ANNEX III

Week of February 21 (Team Discussion)

(This Annex is presented primarily for archival purposes. It represents discussions and research within the ARD/Checchi/JURECO team for the week in question. References to the December draft are to the draft of Articles 1-21 as presented by JURECO in early February, 2000. The Articles below were presented by ARD/Checchi/JURECO on March 9, 2000. Draft Article 23 as presented appears as Article 28, whereas draft Article 22 as adopted by CRDA appears as Article 22. Other references in this text do not necessarily correspond to the final text as adopted by CRDA.)

Article 22 The respective right of the *crédit bailleur* and the law of the state wherein the real estate is located regulates title to real estate.

Annotation: This is a choice of law clause proposed as a result of the need for clarification on international crédit-bail. This is in accord with the Prelude to the UNIDROIT Convention on International Financial Leasing, International Institute for the Unification of Private Law (hereafter referred to as UNIDROIT) Article 4, subarticle 2.

Article 23 The courts of Madagascar are bound to give full faith and credit to judgments of courts and forums for dispute resolution outside Madagascar in matters concerning crédit-bail, notwithstanding the identity of the parties to the crédit-bail transaction, the source of financing for same, the location of the asset subject to lease or the place of execution of the lease or documents of financing, provided that such judgments are in full accord with Article 7 herein.

Annotation: International financing may be essential for crédit-bail and thus the potential of foreign litigation exists. Madagascar is apparently not a signatory to the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitrage Awards. Nor is Madagascar a Member of the International Center for the Settlement of Investment Disputes. Hence, there is need to offer assurances that Malagasy courts will accord comity to the determinations of foreign courts and legitimate forums for dispute resolution.

Article 24 The act of placing an asset at the disposition of the *crédit preneur* as set forth in Article 1 may include or be limited to financing by the *crédit bailleur* or by a party other than the *crédit bailleur*. Financing as set forth herein shall mean: (1) any act undertaken by the *crédit bailleur* to secure money or anything else of value in order to acquire or create the asset subject to lease; or (ii) any act in accordance with the terms of the lease and, the terms of Article 3 hereof, in such manner that *crédit preneur* may exercise the right to purchase at the expiration of the lease.

Annotation: This draft article combines the approaches of Articles 1 and 2 of the December draft as adopted by the Commission but takes further account of international standards. This draft article takes into account the range of commercial configurations contemplated by international commercial practice. International commercial practice demands a prompt and direct textual

reference to the commercial reality of crédit-bail as (often) a three party transaction involving financing through the *crédit bailleur*. The Prelude to UNIDROIT immediately acknowledges that leasing is often a "distinctive triangular relationship." The Commission's acceptance of Article 5 of the December draft acknowledges this possibility of triangularity in the context of a third-party supplier of the property subject to lease. It remains to extend the idea to include within the "operations" of crédit-bail the party bringing finance as well as property. In fact, the *crédit bailleur* may be the supplier of equipment in a finance lease (see Uniform Commercial Code (1990) hereinafter referred to as UCC Art. 2A) or the financier of a construction project in which the *crédit preneur* is already the owner of the property subject to lease, as the preface to the December draft notes. This draft article takes into account these possibilities and others. The definition of financing to take into account the "operations" of crédit-bail under Malagasy law as a three party as well as a two party transaction is crucial. See explanation *infra*.

Subsection (ii) above takes into account a simple crédit-bail in which such financing as is done is simply a result of the *crédit bailleur* permitting utilization of the asset pursuant to lease payments. An international team of analysts on capital markets thus focused on crédit-bail and the role of the *crédit bailleur*, not necessarily as a proprietor but as a financier either of the asset subject to lease or activities conducted on it. Fouzi Mouri, Annexe 2, Part II.2, HIID Report (Version Provisoire).

But subsection (i) in the definition of financing is equally if not more important. This is because, prior to the lease itself, the *crédit bailleur* may need financing to acquire the asset in question. Although this financing from a third party not a party to the lease is prior to the formal relation between *crédit bailleur* and *crédit preneur*, the present law of crédit-bail in Articles 64 and 67 of Chapter IV of Droit Bancaire correctly identifies the purchase by the *crédit bailleur* of the asset subject to lease as an integral part of the "operations" of crédit-bail. (This Chapter on crédit-bail hereinafter cited as D.B., with specific articles then referenced). In fact, in the case of credit mobilier, Article 64 freely acknowledges the prior purchase by the *crédit bailleur* and clearly anticipates the eventual lease with a *crédit preneur*. As to credit immobilier, the preface to the December draft has an excellent resume of sophisticated transactions such as a "bail a construction" in which a *crédit bailleur* assumes control of responsibility for obtaining and meeting the obligations of financing provided by a third party. Unfortunately, although the present law views the acquisition of the asset by the *crédit bailleur* as part of the "operations" of crédit-bail, the crucial role of third-party financing is not discussed in the law).

This treatment in the law is essential to conform to modern leasing practice. Under modern international leasing practice, the *crédit bailleur* may in fact primarily play the role of a financier rather than in the traditional role of a party having permanent and standing title and control over the asset subject to lease. Thus, such asset as the *crédit preneur* desires to purchase may or may not have been in the full ownership and control of the *crédit bailleur*. Most importantly, the *crédit bailleur* may need financing in order to procure the goods; this inclusion of third-party financing is deemed an "aspect of leasing". Cf. Uniform Commercial Code Article 2A (1990) (Uniform Law Commissioners and American Law Institute) (hereafter referred to as UCC Art. 2A). In this one crucial respect, Articles 64 and 67 of D.B., in deeming the *crédit bailleur*'s underlying purchase of the asset subject to lease part of the "operations" of crédit-bail, is in conformity with modern practice.

Article 25 As to obligations arising from and over the duration of the lease, the right of the *crédit preneur* to purchase of the asset subject to the lease shall be subject to only those claims and defenses as arise from: (1) a breach of those provisions of the lease by the *crédit preneur* that relate to the performance of personal obligations not directly concerning operation or maintenance of the asset subject to lease, including but not limited to lease payments; and (2) a breach of the terms of any obligation in connection with financing as set forth in Article 1 hereof, provided that the *crédit preneur* has notice of same through (i) the circumstances outlined in Article 6 hereof; (ii) public record as determined by law.

Nothing herein shall be construed to limit the terms of contract between the *crédit bailleur* and any party to an arrangement to finance the acquisition of the asset subject to the lease or to otherwise facilitate a transaction of crédit-bail.

Annotation: This point concerns the intersection of the terms of the lease and the option to purchase the asset subject to lease at the expiration of the lease. The latter is a personal right under Malagasy law but the rights under a lease may be personal or real. The question becomes whether the *crédit preneur*'s breach of an obligation pertaining to the property impairs the *crédit preneur*'s opportunity to transfer the option to purchase the asset subject to lease. There is little offering affirmative guidance in Malagasy law on this point. However, Malagasy law does suggest that obligations can be divisible in the context of indebtedness. Article Loi 66 du 2 juillet, Art. 29-35 (regarding general obligations, referred to as Loi 66). This draft Article provides for distinction between personal and real obligations in such a way that a breach of lessee obligations by the *crédit preneur* does not affect the ability of the *crédit preneur* to transfer obligations. This is entirely consistent with the position in Malagasy commercial law that in the event of uncertainty, commercial provisions should be resolved in favor of the debtor who is, in the instance of crédit-bail, the *crédit preneur*. Loi 66, Art. 126.

Article 26 Transfer of the right to purchase the asset subject to crédit-bail may be made to any physical or legal person, notwithstanding any limits under law on the capacity of said transferee to eventually assume title and ownership of such asset.

Annotation: This draft incorporates Article 6 of the December draft but takes into account international practices. Article 3 of UNIDROIT foresees value not only in the physical asset subject to lease but the value of the option itself. Insofar as this international practice recognizes value in the right to purchase the asset subject to lease, the revised law on crédit-bail should recognize that this right may be transferred to domestic or foreign financiers who have no intention of actually owing the property subject to this right but will raise capital based on selling a package of rights to purchase so as to minimize the risk of any single crédit-bail. *Cf.* World Bank Country Study, International Bank for Reconstruction and Development, p.p. 127-29 (1993) (elaborating on economics of risk allocation).

Article 27 The right to purchase the asset subject to lease shall mean the option of the *crédit preneur* to take full ownership and title and shall not be construed by this law to empower the

credit prenuer, upon expiration of the lease, to continue the lease, to mortgage or hypothecate said right or to otherwise encumber the interest of the *crédit bailleur* in said asset.

Annotation: It does not appear clear in the Malagasy law of property whether the grant of a full property right in the future implies a lesser right to rent or hypothecate the property in the future. This draft Article intends to resolve the situation by establishing the norm that the *crédit preneur* has only the right of purchase at the expiration of the lease. This is in conformity the outline of expectations in a modern commercial setting, as set forth in with UNIDROIT, Article 9, and subarticle 2.

Article 28 Parties other than the *crédit bailleur* and the *crédit preneur*, through the provision of financing or anything else of value, without which a transaction of crédit-bail would not be effected, as evidenced by the terms of contract or course of dealing, are held to have knowledge of, and be subject to the defenses arising from, the lease between the *crédit bailleur* and the *crédit preneur*, only in the event of one or more of the following circumstances:

(i) such third party is a party to the terms of a contract with either the *crédit bailleur* or the *crédit preneur* for financing or other means of facilitating the crédit-bail;

(ii) such third party effects physical or legal delivery to either the *crédit bailleur* or the *crédit preneur* of the asset subject to lease or anything of value, including any delivery to a *crédit bailleur* or *crédit preneur* with whom such third party enjoys no privity of contract;

(iii) such third party undertakes any other action consistent with knowledge of the terms of the lease between the *crédit bailleur* and the *crédit preneur*, including but not limited to the act of accepting payments under the terms of a contract of financing or other contract facilitating the crédit-bail

The above applies to obligate such third party under the circumstances stipulated, notwithstanding the failure of any party to properly record any document in question as required by law.

Annotation: Third-party financing is only viable if lenders to a *crédit bailleur* or other party have a firm understanding of their responsibilities under law in a crédit-bail situation. Existing Malagasy law does not yet take into account the subtleties of the crédit-bail situation. As the prelude to the December draft suggests, the *crédit bailleur* may deliver either financing, the asset subject to the lease or both. These possibilities imply the role of third parties in crédit-bail. This draft Article elaborates upon the Commission's acceptance of Article 5 of the December draft in view of international practices. As suggested by Article 1, subarticles 1-2 of UNIDROIT, the equipment supplier may exist in privity of contract with the *crédit bailleur* only, with the former providing the asset subject to lease and the latter primarily the financing. Article 5 of the December 5 draft sets forth the general understanding of supplier liability to the *crédit bailleur*. This draft elaborates on this principle, taking into account the reality, reflected in both Article 1 of UNIDROIT and UCC, Article 2 A, that physical control by the *crédit bailleur* is less determinative of obligation than the performance of acts by third-party suppliers such as the transmittal of funds and the receipt of financing payments from the *crédit bailleur*. In addition

to the equipment supply situation, this draft Article also covers a situation whereby the third party is not a supplier of equipment but a financial institution holding a mortgage executed by the *crédit preneur* on real estate leased by the *crédit bailleur*. No present provision of Malagasy law covers both these mobilier and immoblier contexts, as they are outlined in the prelude to the December draft.